

Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 SP-02 ICA-11 AID-05 EB-08 NSC-05
TRSE-00 SS-15 STR-07 OMB-01 CEA-01 CIAE-00
COME-00 FRB-03 INR-10 NSAE-00 XMB-02 OPIC-03
LAB-04 SIL-01 DODE-00 PA-01 /094 W
-----089597 150312Z /61

R 141542Z AUG 78
FM AMCONSUL RIO DE JANEIRO
TO SECSTATE WASHDC 6575
INFO AMEMBASSY BRASILIA
AMCONSUL SAO PAULO

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E.O. 11652: N/A
TAGS: EFIN, BR
SUBJECT: MONETARY CONCERNS PROMPT EXTENTION OF FREEZE ON FOREIGN
LOAN CONVERSION TO 150 DAYS

REF: (A) BRASILIA 5591, (B) RIO 3608

1. THE CENTRAL BANK HAS ANNOUNCED AN INCREASE FROM 120 TO 150 DAYS IN THE PERIOD DURING WHICH PROCEEDS FROM FOREIGN LOANS WILL BE HELD BEFORE BEING CONVERTED TO CRUZEIROS. THIS EXTENTION (CONTAINED IN CIRCULAR 389) BECOMES EFFECTIVE AUGUST 14 AND THUS FOLLOWS THE EARLIER EXTENTION OF 30 TO 120 DAYS BY APPROXIMATELY ONE MONTH (CIRCULAR 385 OF JULY 14). THE RESULT WILL BE THAT FOREIGN LOAN DISBURSEMENTS ENTERING BRAZIL AFTER AUGUST 14 WILL BE AVAILABLE FOR USE BEGINNING ONLY ON JANUARY 10, 1979. AS PREVIOUSLY PROVIDED, THE CENTRAL BANK WILL PAY THE INTEREST ON THE LOAN AND COMPENSATE FOR THE LOSS IN THE VALUE OF THE PRINCIPAL DUE TO EXCHANGE RATE DEVALUATIONS DURING THE PERIOD THE LOAN IS FORZEN.

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2. THIS SECOND LENGTHENING OF THE PERIOD OF NON-CONVERTIBILITY OF FOREIGN LOAN INFLOWS WAS PROMPTED BY THE MONETARY AUTHORITIES' CONCERN WITH CONTINUED EXCESSIVE MONETARY EXPANSION. THE RATE OF GROWTH IN THE MONEY

SUPPLY DECELERATED IN JULY COMPARD TO JUNE, IN PART OWING PROBABLY TO THE INITIAL MEASURES TO FREEZE LOAN

PROCEEDS. HOWEVER, 11.4 PERCENT CUMULATIVE EXPANSION IN JANUARY-JULY (THE JANUARY-JUNE FIGURE HAS BEEN REVISED TO 10.8 PERCENT - SEE REFTEL A) STILL EXCEEDED THE MONETARY BUDGET. MINISTER SIMONSEN HAS ACKNOWLEDGED PUBLICLY A MONETARY TARGET OF 37 PERCENT FOR 1978 AND REPORTEDLY CONCLUDED THAT THE PREVIOUS 120 DAY PERIOD WOULD STILL PERMIT EXCESSIVE INJECTION OF CRUZEIROS IN NOVEMBER-DECEMBER GENERATED BY FOREIGN LOANS IN AUGUST-SEPTEMBER.

3. COMMENT - THIS MEASURE APPEARS TO CONFIRM SIMONSEN'S COMMENTS ON THE HIGH LEVELS OF FOREIGN DEBT AND RESERVES EXPECTED BY THE END OF 1978 (REFTEL B). ANTICIPATING CONTINUED FOREIGN BORROWING, THE AUTHORITIES PERCEIVED A NEED TO HEAD OFF THE CORRESPONDING EXPANSIONARY MONETARY EFFECT IN THE LAST TWO MONTHS OF THE YEAR. CENTRAL BANK OFFICIALS HAVE POINTED OUT THAT THE TEMPORARY STERILIZATION OF FOREIGN LOANS IS A MONETARY MEASURE AND NOT A FOREIGN EXCHANGE MEASURE. THEY DO NOT (AT LEAST NOT YET) WISH TO DISCOURAGE FOREIGN LENDING AS WAS DONE WITH A NON-INTEREST BEARING AND NON-ADJUSTED COMPULSORY RESERVE REQUIREMENT ON FOREIGN LOAN INFLOWS IN 1973. FOREIGN BANKERS HAVE NOTED THAT THE INITIAL IMPOSITION OF THE FREEZE IN JUNE-JULY PROMPTED A SHORT-TERM SPURT IN DEMAND FOR RESOLUTION 63 LOANS AS BORROWERS SOUGHT TO PROGRAM FOR ANTICIPATED CRUZEIRO NEEDS. PRIVATE SECTOR LIMITED OFFICIAL USE

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DEMAND FOR FOREIGN LOANS REPORTEDLY HAS LEVELED OFF IN AUGUST BUT CONTINUED HEAVY PUBLIC SECTOR BORROWING COULD STILL HAVE CONTRIBUTED TO AN UNDESIRABLE EXPANSIONARY EFFECT ON THE MONEY SUPPLY IN LATE 1978. THE EXTENSION OF THE NON-CONVERSION PERIOD TO 150 DAYS AT LEAST POSTPONES THE PROBLEM UNTIL EARLY 1979.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: LOANS, CURRENCY CONTROLS
Control Number: n/a
Copy: SINGLE
Draft Date: 14 aug 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978RIODE03609
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D780332-1182
Format: TEL
From: RIO DE JANEIRO
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780867/aaaacebd.tel
Line Count: 101
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 35ed0d64-c288-dd11-92da-001cc4696bcc
Office: ACTION ARA
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 2
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 78 BRASILIA 5591, 78 RIO DE JANEIRO 3608
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 05 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: N/A
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 1748336
Secure: OPEN
Status: NATIVE
Subject: MONETARY CONCERNS PROMPT EXTENTION OF FREEZE ON FOREIGN LOAN CONVERSION TO 150 DAYS
TAGS: EFIN, BR
To: STATE
Type: TE
vdkgvwkey: odhc://SAS/SAS.dbo.SAS_Docs/35ed0d64-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014